

RECEIVED

JAN 3 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:

The National Exchange Carrier Association,
Inc., Proposed Revision of Part 69 of the
Commission's Rules to Allow for Incentive
Settlement Options for NECA Pool Companies

RM-8389

To: The Commission

REPLY COMMENTS OF PUERTO RICO TELEPHONE COMPANY

Puerto Rico Telephone Company ("PRTC"), by its attorneys, hereby submits its reply comments regarding the above-captioned National Exchange Carrier Association, Inc. ("NECA") Petition for Rulemaking, filed November 5, 1993 ("NECA Petition").¹ NECA has proposed that local exchange carriers ("LECs") which participate in the NECA pools be permitted to remain in the pools and at the same time opt to participate in an incentive regulation plan. This plan would benefit both NECA pool members and their customers by permitting pool members to share with customers a portion of their additional earnings brought about by reductions in cost. In its initial comments, PRTC supported NECA's proposal and urged the Commission to adopt it.² The

¹ Public Notice, Report No. 1986, November 16, 1993.

² NECA also proposed an incentive regulation plan for carriers with fewer than 50,000 access lines, streamlined tariff procedures for the introduction of new services by NECA tariff carriers, and pricing flexibility in NECA pools. PRTC supported each of these proposals but limits its reply comments to the

(continued...)

majority of parties who commented on NECA's proposal supported it. AT&T and MCI, however, oppose several aspects of the proposed incentive regulation plan for pooling carriers.

MCI argues that the major flaw of NECA's proposal is the sharing mechanism by which LECs which earn over 150 basis points above the authorized rate of return will first "share" the additional profits with those LECs which earn more than 75 basis points below the authorized rate of return, before returning the rest to their ratepayers.³ MCI's view is that LECs which submit to incentive regulation "should bear the entire risk of under-earning" and that the "sharing" concept is inconsistent with the Commission's price cap decision for LECs.⁴ MCI is incorrect.

As PRTC demonstrated in its Comments, incentive regulation is a superior method of regulation.⁵ It encourages carriers to be efficient -- by rewarding cost reductions with additional profits -- and to be innovative by allowing carriers to retain the profits from their innovations. It also discourages cross-subsidization.⁶ The public interest will be served by

²(...continued)
incentive regulation plan in which it would be permitted to participate, as this is the only issue relevant to PRTC which is in serious contention among the commenters.

³ Comments of MCI Telecommunications Corporation, RM-8389, filed December 16, 1993 ("MCI Comments"), at 5.

⁴ Id.

⁵ Comments of Puerto Rico Telephone Company, RM-8389, filed December 16, 1993 ("PRTC Comments"), at 2.

⁶ Id.

bringing as many LECs as possible under incentive regulation -- increasing the number of ratepayers who receive the benefits of cost reduction and innovation. Without a cap on the losses a LEC may incur, it is likely that many LECs which participate in the NECA pools will be unwilling to submit to the incentive regulation plan. The risks will be too great. The Commission recognized this principle when it adopted a lower end to the earnings band⁷ (75 basis points below the rate of return) in its incentive regulation plan for small and mid-sized non-pooling LECs. A cap on the losses a LEC may incur should also be implemented as part of NECA's proposed incentive regulation plan, a plan which is closely modeled on the Commission's plan for small and mid-sized LECs. This will encourage maximum participation in the incentive regulation plan and maximum benefit to ratepayers.

MCI also contends that the "sharing" mechanism is inconsistent with the Commission's LEC price cap decision, in which it adopted a "lower formula adjustment" ("LFA").⁸ Under the LFA, if a LEC's earnings fall below the lower adjustment mark in a base year period, the LEC may adjust its rates upward to target earnings to an amount which is not to exceed the lower adjustment mark.⁹ MCI argues that the LFA was adopted only "to ensure

⁷ Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, Report and Order, 8 FCC Rcd 4545 (1993) ("Regulatory Reform Order").

⁸ MCI Comments at 5 (citing Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786 (1990) ("LEC Price Cap Order")).

⁹ LEC Price Cap Order, 5 FCC Rcd at 6802.

that the newly adopted price cap regime did not cause LECs to realize especially low earnings over a prolonged period of time."¹⁰ MCI goes on, however, to note that the Commission decided that such a mechanism was necessary "to ensure that price caps did not jeopardize the LECs [sic] ability to attract capital and provide service, yet maintain the incentives for LECs to improve their performance."¹¹ The Commission observed in the LEC Price Cap Order that a lower end adjustment was necessary because forcing LECs to bear the unmitigated risk that their earnings will fall substantially below the authorized rate of return could harm stockholders and, most importantly, customers by endangering quality of service.¹² The Commission also stated that limiting the adjustment to a mark lower than the authorized rate of return, (as the NECA plan would also do), leaves in place the incentive to become more efficient because the lower adjustment mark supports a level of earnings substantially below the authorized rate of return.¹³ This is why the "sharing" mechanism should be adopted here. The incentive regulation plan for pooling companies should encourage efficiency while maintaining the incentive for LECs to participate in the first instance. The NECA plan achieves these objectives.

¹⁰ MCI Comments at 5-6 (emphasis in original).

¹¹ MCI Comments at 6.

¹² LEC Price Cap Order, 5 FCC Rcd at 6804.

¹³ Id.

AT&T concurs with MCI's argument about the sharing mechanism, which has been addressed above.¹⁴ AT&T also contends that because NECA carriers that participate in the incentive regulation plan will continue to charge uniform NECA tariffed access rates, there will be no reduction in rates and thus no increased efficiency and stimulation of demand.¹⁵ Clearly though, as NECA pool members become subject to incentive regulation under the NECA plan and reduce their costs, the total costs of all NECA pool members will fall, causing the uniform NECA tariffed access rates to fall. This will benefit the ratepayers of all LECs which participate in the NECA pools. This is a potentially greater benefit to ratepayers than the existing price cap plans because the efficiencies created by an individual pooling LEC will accrue to all ratepayers served by the pooling companies.

Finally, AT&T opposes the optional aspect of the plan, arguing that LECs which anticipate low costs over the next tariff period will participate in incentive regulation and those which anticipate high costs will remain under regular rate of return regulation.¹⁶ The Commission has already dealt with this issue in its proceeding on incentive regulation for small and mid-sized non-pooling carriers. It concluded there that incentive regulation should be optional because the wide variation in the characteristics of the carriers which might participate in incentive regulation makes it difficult to predict how the

¹⁴ Comments of American Telephone & Telegraph Company, RM-8389, filed December 16, 1993 ("AT&T Comments"), at 5.

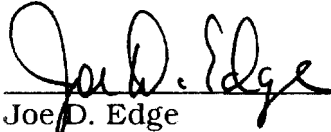
¹⁵ Id. at 5-6.

¹⁶ Id. at 6.

plan will affect each of them.¹⁷ This is also true of the NECA pool members. Therefore, the NECA plan should be optional.¹⁸

For the reasons stated here, the Commission should adopt NECA's proposed incentive regulation plan for NECA pool members.

Respectfully submitted,



Joe D. Edge
Elizabeth A. Marshall

Hopkins & Sutter
888 Sixteenth Street, N.W.
Washington, DC 20006
(202) 835-8000

Counsel for Puerto Rico Telephone Company

January 3, 1994

¹⁷ Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, Notice of Proposed Rulemaking, 7 FCC Rcd 5023, 5027 (1992); Regulatory Reform Order, 8 FCC Rcd at ¶ 62.

¹⁸ See also Comments of the United States Telephone Association, RM-8389, filed December 16, 1993, at 2; Comments of the National Telephone Cooperative Association, RM-8389, filed December 16, 1993, at 4-5; Comments of the Organization for the Protection and Advancement of Small Telephone Companies, RM-8389, filed December 16, 1993, at 3-4.

CERTIFICATE OF SERVICE

I, Jean M. Layton, hereby certify that a copy of the foregoing Reply Comments of Puerto Rico Telephone Company was mailed, postage prepaid, this 3rd day of January, 1994 to the following:

Joanne Salvatore Bochis, Esq.
National Exchange Carrier
Association
100 South Jefferson Road
Whippany, New Jersey 07981

Christopher J. Watkins
PTI Communications
805 Broadway
P.O. Box 9901
Vancouver, WA 98668-8701

International Transcription Service,
Inc.
2100 M Street, NW
Suite 140
Washington, DC 20037

James A. Sanborn
United Telephone Company
P.O. Box 577
Farmington, NH 03835

Lisa M. Zaina
OPASTCO
21 Dupont Circle, NW
Suite 700
Washington, DC 20036

Francine J. Berry
American Telephone and Telegraph
Company
295 North Maple Avenue
Room 3244J1
Basking Ridge, NJ 07920

David Cosson
National Telephone Cooperative
Association
2626 Pennsylvania Avenue, NW
Washington, DC 20037

Randy R. Klaus, CPA
MCI Telecommunications
Corporation
701 Brazos Street
Suite 600
Austin, TX 78701

Linda Kent
United States Telephone
Association
1401 H Street, NW
Suite 600
Washington, DC 20005-2136

Lawrence P. Keller
Cathey, Hutton & Associates, Inc.
3300 Holcomb Bridge Road
Suite 286
Norcross, GA 30092


Jean M. Layton